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JAMAICA AND THE INTERNATIONAL MONETARY FUND: ECONOMICS OF THE 1978 STABILIZATION PROGRAM

by

Compton Bourne
Visiting Professor

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Agricultural Finance Program
Department of Agricultural Economics and Rural Sociology
The Ohio State University
2120 Fyffe Road
Columbus, Ohio 43210

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Introduction

The relationship between the International Monetary Fund (IMF) and developing countries has tended to be volatile and frequently acrimonious Recent writings document the controversy, breakdown, and reestablishment of relationship between the IMF and deficit countries such as Brazil, Indonesia, Ghana, Sri Lanka, Peru and Zaire to name just a few (McCauley (3), Payer (4) and Stallings (5)). In each case, loan conditionality has been the core of the dispute.

Jamaica is the latest in the series of problem cases. Twice within the past three years, the Jamaican political leadership has broken off negotiations with the IMF on the grounds that its conditions for balance of payments support are unnecessarily harsh and socially unacceptable. On the first occasion (January 1977), the crux of the dispute was the deflationary effects of the exchange rate devaluation proposed by the Fund. In April 1977, after unsuccessfully pursuing alternative financing among countries in both the socialist and capitalist worlds, the Jamaican government reversed its position and accepted a standby loan from the IMF. The second episode results from the failure of the economy to satisfy some criteria embodied in an Extended Fund Facility loan agreement made in May 1978. Renegotiation of the program broke down over the IMF's requests for sizable reductions in deficit financed expenditures. The Jamaican government once more announced its intention to attempt alternative solutions to its balance of payments problem. Presumably, it is again seeking credit from the socialist bloc. An important new development may be unilateral rescheduling of the country's foreign debt which extensive foreign exchange rationing has caused to be seriously in arrears.

Several important questions arise from this series of events. How adequate and reasonable is the IMF stabilization program? How feasible are the alternative adjustment policies? What are the implications for Jamaica's international relationships? This paper deals with the first issue, the significance of which is indicated by the fact that large segments of Jamaican society endorse their government's opinion of the IMF stabilization program. Moreover, the constancy of this view in widely varying LDC settings underscores its salience for IMF-LDC relationship. A case study of the Jamaican experience can serve a useful purpose by elucidating this issue and by so doing aid better program design and sober consideration by the parties involved. The particular stabilization program examined is the 1978 Extended Fund Facility loan agreement. My approach is to first describe and analyze the balance of payments crisis. Next, the stabilization program is outlined and assessed in terms of its adequacy and adjustment costs.

The Severity of the Payments Crisis

Jamaica is a small Caribbean island economy. It is eleven thousand square kilometers large, with a population of 2.2 million persons. Its per capita income in 1970 was J$600 (U.S. $720). The economy is dependent on the rest of the world for its supply of goods and, to a lesser degree, finance. Foreign trade constituted 74 percent of GNP in 1970. Exports comprised 35 percent and imports 39 percent. Net foreign borrowing amounted to 30 percent of national savings. The unemployment rate is between 20 to 23 percent according to official estimates. Until the 1970s, domestic price inflation was mild, not exceeding 3 percent per annum up to 1967, then rising to 6 percent in 1969. Real per capita national income grew at an average annual rate of 4 percent between 1965 and 1970. Table 1, column 3 shows that small balance of payments surpluses were consistently achieved. However, during the 1970s, all that changed. The economy went into prolonged recession. Real per capita national income declined in each year of that decade, at an average annual rate of 3 percent. Annual inflation rates rose rapidly from 9 percent in 1972 to an average of 22 percent between 1974 and 1975 and after decelerating to 10 percent during the next two years, accelerated to 48 percent in 1978. Open unemployment grew from 18 percent of the labor force in 1970 to 24 percent in 1977.

Several indicators reveal the magnitude of the international payments problem in the 1970s (Table 1). The overall balance of payments, measured by changes in official reserves, moved from a surplus of J$36 million in 1971 to a deficit of J$44 million 1972. Deficits persisted thereafter, reaching the alarming level of J$238 million in 1976. The current account deficit widened from J$145 million in 1970 to J$275 million in 1976. Private net capital inflows, which historically performed an equilibrating role, became increasingly

Table 1. Jamaican Trade and Payments Performance (J$ million)

	Merchandise Trade Balance	Current Account Balance	Overall Payments Balance
1965	- 27	- 22	10
1966	- 6	- 30	17
1967	- 18	- 51	14
1968	- 68	- 86	28
1969	- 74	-103	- 11
1970	- 89	-145	18
1971	-109	- 93	36
1972	-121	-117	- 44
1973	-161	-164	- 28
1974	-107	-152	54
1975	-145	-257	- 74
1976	-120	-275	-238
1977	85	- 31	- 15
1978	47	- 60	- 70

Note: Minus sign indicates a deficit.

SOURCE: Bank of Jamaica, The Balance of Payments of Jamaica, various years.

inadequate after 1970, and practically ceased by 1976. For a while, government foreign borrowing helped to offset the decline in private capital inflows, but in 1977 government debt payments exceeded new debt inflows by J$5 million. As a consequence of these trends, the economy rapidly lost international reserves. Net foreign assets of the central bank amounted to J$137 million in 1970, contracted somewhat during the next two years, recovered to $141 million in 1974, and then fell sharply and continuously. By December 1977, net foreign reserves were _minus_ J$171 million. The large negative foreign reserve balance is the net outcome of a reduction of gross foreign reserves from J$168 million in 1974 to J$43 million in 1977, and a growth of gross foreign liabilities from zero in December 1972 to J$214 million in December 1977. Indisputably, therefore, by the end of 1976 the Jamaican economy had a balance of payments problem of immense proportions.

The Causes of the Payments Crisis

Jamaican policymakers emphasize external influences on the balance of payments, namely energy price increases, adverse terms of trade, the slackening of capital inflows, and the investment income remittances. Domestic inflation was attributed to external causes and was regarded as an effect of the payments disequilibria. Corrective policies independently adopted prior to 1978 were conscious attempts to adjust the economic behavior of resident households and corporations to the perceived adverse external situation. The set of measures, differing in scope and severity of application, included quantitative restrictions on credit to the private sector, wage and price guidelines, and exchange controls on imports and capital transactions. While partially correct, the official diagnosis is seriously deficient in its neglect of domestic production and supply problems and the economic destabilizing influence of government transactions. It will be argued that the Jamaican balance of payments crisis was not so much the outcome of external forces as of serious problems of domestic economic management.

While important, the behavior of external prices and capital flows were not central causes of the balance of payments crisis. The export price index in domestic currency rose less rapidly than the import price index (Table 2, Columns 2 and 3). As a consequence, the net barter terms of trade tended to deteriorate during the 1970s, though never becoming significantly nor persistently adverse. It is also incorrect to attribute the balance of payments problem primarily to energy prices. The first major deficit occurred in 1972, two years prior to the OPEC oil price increases. The first upsurge of import prices coincided with the 1973 exchange rate devaluation. More accurately, energy prices aggravated the deficit by increasing the costs of fuel imports and by causing inflation among Jamaica's main import suppliers.

Outflows of investment income were not an important cause of the deficit. Outflows of investment income averaged J$55 million in current prices (J$42 million in constant prices) between 1970 and 1974, compared with J$59 million in current prices (J$67 million in constant prices) between 1965 and 1969 (Table 3, column 1). The sizable outflows (in nominal terms) which did occur between 1975 and 1978 were service payments

Table 2. Indices of Jamaican Dollar Prices of Imports and Exports, and Net Barter Terms of Trade (1974 = 100)

Year	Import Prices	Export Prices	Net Barter Terms of Trade
1965	35	32	92
1966	36	40	111
1967	37	42	113
1968	43	45	106
1969	43	46	107
1970	44	52	117
1971	53	51	96
1972	52	53	101
1973	69	57	83
1974	100	100	100
1975	112	131	117
1976	118	128	108
1977	152	133	88
1978	219	212	97

SOURCE: Jamaica Department of Statistics Statistical Abstract, various years.

on debts incurred by the government to finance the fiscal and international payments deficit. Gross outflows of portfolio income were as little as J$12 million in 1972. Large government Eurocurrency debts were incurred after 1973, as a consequence of which outflows of portfolio income rose to J$70 million in 1976 and $120 million in 1978. Foreign capital inflows practically ceased after 1975. Foreign direct investment, which offset the current account deficit until 1971, declined drastically beginning in 1972, and became negative after 1975 (Table 3, column 3). The growth in official foreign debt between 1973 and 1976 obscured this trend (Table 3, columns 4 and 5). Altogether, total net inflows of foreign capital contracted from J$ 134 million in 1970 to J$60 million in 1972, recovered to a peak of J$221 million in 1974, before declining rapidly thereafter (Table 3, column 3). To make matters worse, import price inflation eroded the foreign exchange value of these inflows. Net capital inflows (deflated by the import price index) declined from J$134 million in 1970 to J$51 million in 1972, rose to $98 million in 1974, and then fell to $15 million in 1977. On the basis of these trends, it must be concluded that capital outflows are not the cause of the payments imbalance. On the contrary, gross inflows were simply no longer sufficient to finance the current account deficit.

Close examination of the merchandise trade and service accounts reveals that serious problems lie on the supply side and in the performance of the economy. The payments crisis may be attributed to the rather more fundamental problems of deteriorating productive capacity and performance, rapid bureaucratic growth, domestic credit expansion, and inflation.

Table 3. Capital Flows in the Jamaican Balance of Payments (Millions of Current Jamaican Dollars)

Year	Investment Income	Net Capital Inflows	Direct Investment	Other Private Capital*	Govt. Capital
1965	- 31	12	n.a.	n.a.	n.a.
1966	- 65	47	n.a.	n.a.	n.a.
1967	- 67	65	n.a.	n.a.	n.a.
1968	- 61	114	101	0	12
1969	- 72	92	85	0	10
1970	- 82	134	134	3	- 1
1971	- 38	112	146	8	4
1972	- 43	60	21	11	19
1973	- 53	125	20	69	33
1974	- 61	221	21	102	82
1975	- 93	190	- 2	73	112
1976	-105	41	- 1	10	72
1977	-126	52	- 6	4	- 5
1978	-169	9	- 24	-161	163

Notes: * Primarily government-guaranteed debt of public enterprises.

SOURCE: Bank of Jamaica, The Balance of Payments of Jamaica, various years.

The merchandise trade deficit stems mainly from poor export performance. Merchandise exports (in 1970 prices) after growing slowly between 1967 and 1974, declined sharply from J$327 million in 1974 to J$243 million in 1976 and still further to J$178 million in 1978. Quantitative restrictions caused merchandise imports to contract even more severely. Imports, having grown rapidly from J$259 million in 1967 to a peak of J$374 million in 1970, declined consistently to J$138 million in 1978. Nonetheless, these import restrictions, though applied with increasing stringency, could not compensate for the deterioration in export trade.

The export performance reflects production shortfalls. The data in Table 4 show that production of the major exports decreased. The indices of physical production for bauxite and alumina, which comprised 65 percent of total exports in 1970, fell from 125 in 1974 to 97 in 1978 for bauxite and from 167 to 125 for alumina. The production decline in the sugar industry is even more striking. Sugar is the second largest commodity export, comprising 11 percent of total exports in 1970. The index of physical production declined continuously from 135 in 1966 to 100 in 1970 and 77 in 1978. The output index for bananas, which comprised 4 percent of total exports, declined in similar fashion. Stagnation characterizes the production history of the other agricultural exports such as coffee, cocoa, pimento, and ginger. Exports of manufactured goods (excluding sugar) account for 8 percent of total merchandise exports. Although no composite indices for manufacturing production are available, it seems that production did not decline until import restrictions reduced the supply of vital imported inputs.

Table 4. Indices of Physical Production (1970 = 100)

Year	Bauxite	Alumina	Sugar	Bananas	Coffee	Cocoa
1965	140	44	132	112	81	152
1966	75	46	135	124	66	103
1967	76	49	121	141	68	41
1968	70	54	120	114	75	98
1969	88	68	103	112	56	97
1970	100	100	100	100	100	100
1971	104	109	102	94	98	87
1972	107	121	101	95	82	135
1973	111	146	88	80	56	27
1974	125	167	99	53	17	78
1975	92	131	96	52	27	97
1976	86	95	98	59	4	94
1977	94	119	78	60	125	108
1978	97	125	77	58	72	155

SOURCE: Computed on basis of data in Bank of Jamaica Balance of Payments of Jamaica, various years.

Productivity also declined in the export agricultural industries. The index of cane harvested per acre (a measure of agricultural productivity) fell continuously from 100 in 1970 to 84 in 1975, and though recovering subsequently still remained below the 1970 level. The index of the cane-to-sugar conversion ratio (a measure of sugar manufacturing productivity) declined from 100 in 1970 to 87 in 1975, recovering slightly thereafter.

The problem with respect to exports of services lay on the demand side. Tourism, the main source of net foreign travel receipts, was a major growth industry until 1973, contributing 18 percent of total foreign exchange earnings and employing 1.5 percent of the labor force in 1970. Net travel receipts comprised 18 percent of total exports in 1970. Foreign travel receipts decreased drastically from a level of J$80 million (in constant prices) in 1973 to J$17 million in 1976. This contraction, unlike that of merchandise exports, was due to a fall in demand. The number of foreign visitors to Jamaica decreased by nearly a third between 1974 and 1977. Several factors explain the downswing in tourism. Among these are the economic recession in the U.S.A., the origin of 76 to 80 percent of tourists to Jamaica. Compared to mean annual growth rates of roughly 5 percent between 1965 and 1975, U.S. real per capita GNP grew at only 0.5 percent between 1975 and 1977. Since income elasticities of demand range between 1.1 and 1.5 (Bond and Ladman (1), and Ffrench (2)), this trend in U.S. income growth partly explains the sudden and pronounced decrease in U.S. visitors to Jamaica. Further, the rapid domestic inflation, combined with a negative price elasticity of tourist expenditures between 2.6 and 3.8 (Ffrench, 2) also reduced Jamaican receipts from tourism. Other pertinent factors are some local ambivalence and hostility towards tourism and the increasingly unstable socio-political climate.

Output declines in the mining industry were essentially due to falling demand caused by the U.S. economic recession and in part represented a power play by the bauxite companies to force a reversal of higher tax rates imposed by the Jamaican government in 1974. For the remaining export production sectors, output and productivity decreases are linked to the failure of the economy to recapitalize and to expand its capital stock sufficiently. Real net capital formation contracted from J$250 million in 1970 to J$158 million in 1974 and still further to J$85 in 1976. Net capital formation was a paltry J$29 million in 1977. Aggregate domestic savings decreased significantly. Domestic savings which averaged 17 percent of GNP between 1965 and 1970, averaged only 10 percent between 1971 and 1975, and became negative (-0.4 percent) between 1976 and 1977. The government's propensity to consume increased. Public consumption expenditures averaged 75 percent of tax revenue between 1971 and 1976, compared with 63 percent between 1965 and 1970. Personal savings became increasingly negative from as early as 1971. Corporate savings and a rise in the average corporate savings propensity from 46 percent (1965-70) to 57 percent (1971-75) moderated the overall decline in domestic savings until 1976 when corporate savings contracted substantially. Foreign direct investment also helped to boost real national savings in the first three years of the decade. In contrast, a large proportion of portfolio debt was allocated to public consumption.

While it is tempting to attempt to explain the recent investment performance in terms of a capital strike by foreign and local firms in response to the democratic socialist posture of the Jamaican government, more plausible economic reasons can be identified. Rising input costs in the face of domestic price rigidities reduced the level and stability of profits and adversely affected profit expectations. Wage increases ranged from 18 to 45 percent, compared to average annual rate of consumer price inflation between 6 and 27 percent. Commodity price controls became more extensive. Though applications for price increases were frequently approved, the fact that approvals were not always for the full amount sought, that applications were sometimes denied, and the lag between application and approval negatively affected profits levels and profits expectations. Real gross profits remained stable between 1970 and 1973, averaging J$370 million (31 percent of GNP). Gross profits then rose to J$411 million in 1974 (34 percent GNP) and fell thereafter to an average of J$334 million (30 percent of GNP) between 1975 and 1977. Since the propensity to save profits exceeds the propensity to save labor incomes, these adverse shifts in the absolute level of profits and in its share of national income resulted in lower levels of domestic resource accumulation.

The profits depression in the export sector was not caused by any significant fall in export prices. Export prices were not generally depressed (Table 5). On the contrary, export prices in local currency

Table 5. Price Relatives of Jamaican Exports (1970 = 100)

Year	Bauxite	Alumina	Sugar	Bananas	Coffee	Cocoa
1965	53	75	76	69	59	62
1966	100	76	84	72	59	64
1967	100	79	88	78	66	88
1968	100	91	91	102	84	92
1969	100	94	98	94	89	92
1970	100	100	100	100	100	100
1971	100	92	103	106	118	96
1972	97	88	126	106	139	96
1973	109	101	140	172	170	148
1974	162	193	284	180	252	184
1975	198	230	568	244	241	180
1976	281	269	250	176	325	184
1977	233	266	329	253	498	268

SOURCE: Computed on basis of data in Bank of Jamaica Balance of Payments of Jamaica, several years; and Owen Jefferson Post War Economic Development of Jamaica, Kingston, Jamaica, Institute of Social and Economic Research, University of West Indies, 1972.

tended to rise. Price depressions, when they occurred (e.g. sugar in 1976, bananas in 1975), were shortlived. It is possible that gains in export prices were not transferred to producers by the quasi-governmental export marketing boards, but present data constraints do not permit examination of this possibility.

Domestic price inflation was an important influence on the balance of payments. Inflation generated increases in labor and other input costs. It also reduced the real value of profits. Furthermore, inflation by increasing nominal expenditures raised imports. Two basic factors contributed to Jamaica's inflation: import prices and domestic credit. Import prices rose at an average annual rate of 25 percent between 1970 and 1977, compared to 6 percent between 1965 and 1970. Imported inflationary pressures reinforced those attributable to monetary and credit expansion. Total domestic credit of the monetary sector expanded from J$277 million (25 percent of GNP) in nominal terms in 1970 to J$1291 million (49 percent of GNP) in 1977. In real terms, the growth of credit outstripped that of real resource availability by a wide margin, thereby contributing to price inflation.

Government behavior occupies a central place in Jamaica's balance of payments experience. A variety of subsidies and credit programs to expand exports proved ineffective in the prevailing situation of inadequate product prices, high costs of production, input supply problems, and credit supply rigidities. Simultaneously, much of the inflationary expansion of domestic credit was due to mounting budgetary deficits financed by the banking system. The deficit (in real terms) increased from J$41 million (4 percent of GNP) in 1970 to J$187 million (17 percent of GNP) in 1976. Nominal central bank direct credit to the central government mushroomed from J$4 million in 1971 to J$402 million in 1977. If one adds indirect credit in the form of overdrawn deposit accounts, the estimates of central bank financing would be considerably larger, for example by J$100 million in 1975. Commercial banks lending to the government increased rapidly as well, from J$44 million (11 percent of bank assets) in 1970 to J$248 million (33 percent of bank assets) in 1977. Apart from causing inflation, this massive expansion of government debt displaced private sector debt, including that of productive enterprises. Government debt as a percentage of total debt rose from 11 percent in 1970 to 50 percent in 1977. Furthermore, the average ratio of taxes to GNP increased from .17 in 1970 to .28 in 1977. Through its credit and fiscal operations, the Jamaican government succeeded in bidding away real resources on an increasing scale. Government share of the labor force rose, particularly during the latter half of the 1970s from 11 percent in 1974 to 15 percent in 1977. Its share of labor remuneration increased even faster from 16 percent in 1970 to 27 percent in 1977. The share of government in total consumption expenditures rose from 17 percent in 1970 to 24 percent in 1977. No data is available on its share in total imports. However, the exemption of government transactions from the stringent import restrictions implies that government's share became larger. In effect, the government facilitated its own requirements by crowding out the import demands of the private sector.

To some extent, this increasing command over real resources resulted from government take-over of enterprises which either ceased or were about to cease operations. The objective in such cases was to avert greater unemployment. These take-overs were sometimes to protect government's financial interests in cases where government owned equity or had guaranteed bank loans to the enterprises. In a few instances, the expansion of government was in fulfillment of the policy of increasing government's share of productive activity. In all three situations, government activities simply replaced private productive activity. However, much of government expenditures were of a consumption nature. The national income data reveal that government consumption expenditures increased at an annual average rate of 13 percent between 1970 and 1977. Income redistribution and short-term employment objectives rather than production objectives dominated government expenditure programs. Thus basically nonproductive programs, such as the Special Employment Program introduced in 1972 as a temporary form of unemployment relief, grew throughout the decade. As another example, educational expenditure programs, e.g. Free Secondary Education, while having a longrun investment component were conceived essentially as redistributive measures.[2] The trends in government consumption and the social welfare nature of many of the public programs indicate that the main effect of governmental growth was the substitution of public consumption and less productive public expenditures for more productive private expenditures. Bureaucratic growth, through its resource allocative effect, further undermined the productive capacity and performance of the economy, and thereby its balance of payments performance.

The central conclusion to be drawn so far is that the Jamaican balance of payments crisis is largely attributable to the poor export and production performance of the economy, domestic credit expansion, inflation, and excessive growth of governmental services. As such, effective corrective policies must be directed to these fundamental areas of public economic management. Accordingly, the IMF stablization program is assessed in terms of this diagnosis and in terms of the adjustment costs it imposes on the society.

The IMF Stablization Program

The Standby Agreement of 1977 was a forerunner to the Extended Fund Facility agreed upon in 1978. The former embodied the Jamaican decision to adopt a dual exchange rate system, under which government foreign transactions, imports of some foods and medicines, and the foreign transactions of the bauxite industry were to be based on the previously existing exchange rate. All other transactions were to be based on a new rate, representing a 37.5 percent devaluation of the currency. The agreement also required the government to reduce its fiscal deficit and its reliance on central bank credit. The Standby Agreement was a compromise agreement which does not fully convey the IMF position about the causes of and solutions to the Jamaican balance of payments problem. In contrast, the Extended Fund Facility agreement, which Jamaica signed at a time of dire need, fully reflects the IMF's views. For this reason, the following appraisal is limited to the Extended Fund Facility.

The stabilization program planned for a fall in public and private consumption expenditures, and an increase in fixed investment expenditures as a percentage of GDP.[3] Gross investment was projected to increase from 10.4 percent to 21.8 percent of GDP over the 3-year program period, and government capital expenditure from 12.1 percent to 12.8 percent. The increased investment expenditure was to be financed not by credit creation but by appropriate increases in the government and private sectors savings ratios. Government revenue was planned to increase from 22.5 percent of GDP to 28.1 percent, and government current expenditure to decline from 23.7 percent to 20.2 percent. Correspondingly, it was intended that the budget deficit would decrease from 13.4 percent to 4.5 percent and government savings would increase from minus 1.3 percent of GDP to 7.9 percent. By imposing wage guidelines which limited increases in gross labor remuneration to 15 percent per annum over a two year period, and by decontrolling prices, the program sought to increase the level and the share of profits, thereby augmenting domestic financing capacity. In addition, the removal of subsidies from goods and services produced by public enterprises and corresponding increases in their prices were intended to reduce public consumption and improve the profitability of public enterprises. Altogether, the program planned for an increase in domestic financing of investment as a proportion of GDP from 7.6 percent in 1978 to 19.4 percent in 1981. Greater dependence on foreign financing of gross accumulation was not envisaged.

The agreement stipulated the immediate unification of the exchange rate, and a devaluation of 15 percent, followed by a phased one totalling an additional 15 percent over twelve months. Restrictions on payments and imports were to be gradually removed during the program period. Arrears on foreign debt payments were to be quickly reduced. Specifically, arrears were to be decreased from U.S. $82 million in March 1978 to U.S. $20 million by March 1979.

The IMF agreed to provide U.S. $240 million in loan funds over the three year life of the program. It was also projected that the economy would, with the help of the IMF, obtain new private foreign credits, would be able to refinance its short and medium term debts, and would attract new direct foreign investment. However, the stabilization program in order to restrain the growth of already troublesome debt service payments imposed ceilings of U.S. $100 million and U.S. $20 million on short and medium term debts incurred during the first year of the program.

The analytical framework which underlies the IMF stablization program is implicit in those stipulations pertaining to the expenditure mix, factor incomes, credit and the exchange rate. The higher rate of investment financed by increased domestic savings and stimulated by more bouyant profit conditions would lead in this scheme of things to a higher rate of growth and thus to an improvement in the balance of payments. The curbs on the growth of credit in conjunction with the investment program was intended to reduce the growth rate of inflation. Further, devaluation combined with restrictive monetary policy reduces real money balances and possibly as a consequence import expenditures. It was envisaged that exchange rate adjustment would influence export demand via relative prices and the supply of exports and import substitutes via increased profitability of both home goods and export industries. Clearly, the IMF diagnosed the Jamaica balance of payments problem in terms of lagging economic performance and demand imbalances critically linked to the government sector. In terms of the analysis in this paper, its diagnoses in these respects are essentially correct. The central remaining issue is the empirical validity of the implicit production and growth model, particularly the investment and output supply relationships. Since a stabilization program, by virtue of its differential incidence on various classes and economic groups, is an exercise in political economy, the length and form of the adjustment process assumes critical importance.

It is difficult in the absence of detailed quantitative analysis to be categorical about the likely effects of the stabilization program, especially since later events indicate that important departures from the program were made with respect to public sector wage increases and credit. Nonetheless, some conclusions can be advanced with varying degrees of firmness.

Devaluation is not likely to have a significant depressing effect on Jamaican import demand during this period. This is partly due to the fact that real import demand has already been reduced to the essential minimum, and even below that judging from the lower levels of production caused by import rationing. Given the country's import dependence, the further round of devaluation leads to an increase in the domestic currency value of imports. On the other hand, the exchange rate devaluation has the potential for inducing the supply of exports by increasing the local currency price-cost ratio of export producers, providing that the wage guidelines are enforced. Further, the domestic price level inflation induced by the devaluation operates as a mechanism for factor-income redistribution in favor of profits in import-substituting and domestic industries, again with the proviso that the wage guidelines are binding. Thus, one important potential strength of exchange rate devaluation and complementary wage policy is the possibility of raising the level of profits absolutely and relative to labor incomes. In this context, exchange rate policy is directed towards production. As such, it depends heavily on the responsiveness of producers to profit signals. In the context of the prevailing political and economic uncertainty, input supply rigidities, and capital stock deterioration, it is likely that supply response would be slow. The speed of adjustment is unlikely to be uniform. Agricultural supply response to price though positive,[4] would be slow for well known reasons such as crop maturation lags, establishment periods for perennial crops, and gestation lags for livestock projects. Excess physical capacity in the manufacturing sector guarantees quicker response, all other things being equal. While theoretically, investment demand is expected to respond to profit rates and availability of finance, not much is known about the statistical investment functions for Jamaica. One would expect however, regardless of the strength and time structure of the underlying relationships, that uncertainty about future profits and the sociopolitical climate would delay the response to current improvements in profits and financial capacity. The odds are that growth and supply effects are weak in the shortrun.

There is a consensus that key marketing features for Jamaica's merchandise exports, namely transfer pricing for bauxite and alumina, and quota sales in foreign currency for sugar and bananas, imply weak export demand sensitivities to exchange rate changes. The price elasticity of demand for exports of manufactured goods is not known, but is thought to be significant. Demand for tourism is price sensitive as French's results demonstrate.

Credit effects are fairly predictable. The slower growth of credit depresses aggregate expenditures, thereby reducing import demand. A serious adverse side effect is that credit restraint also reduces the demand for domestic goods thereby tending to weaken profit expectations. This effect is offset to the extent that there are production-related expenditures financed out of savings. Much depends on the lag between these demand contractionary effects and the supply creating effects of the program. Another possibly adverse side effect is the contraction of production that might result from any liquidity squeeze on firms. Jamaican enterprises rely heavily on bank credit for working capital. Global credit restraint can hurt them. However, this does not seem to have been a problem. The banks experienced considerable buildup of liquidity, the ratio of loans to deposits decreasing from .93 in 1975 to .72 in 1977, and .65 in 1978. Moreover, the stabilization program advocated preferential treatment of production credit within the general policy of restraint. As a result, the supply of production credit did not decrease. Instead, credit demand contracted largely as a result of the quantitative restrictions on imports.

Much of the controversy in Jamaica pertains to the employment effects of the target decline in deficit financing. It is important to realize that the reduction in government deficits need not mean a fall in the size of the public sector. Governmental growth may occur if revenues rise. More importantly, the weight of productive expenditures in total public expenditures can increase. In which case, government workers can maintain their jobs by producing goods rather than consumption services. Furthermore, if a contraction of government is accompanied by an expansion of the private productive sector, no unemployment need result. This would require relatively frictionless reallocation of resources. In practice, some friction ensues, with temporarily negative effects on employment and labor incomes. In any event, there is no alternative to a reduction in government deficit expenditures and a shift in government expenditures towards production if stagflationary tendencies are to be reversed.

Unemployment and lower levels of living are the main economic adjustment costs imposed by the stabilization program. Real incomes are likely to fall as a consequence of these unemployment effects and as a result of the devaluation-induced rise in the domestic cost of living. Both the unemployed and the employed are likely to be hurt; the former because they depend on the latter for income transfers. The logic of the program does predict subsequent recovery and growth of employment and real incomes. However, these gains materialize towards the end of the program, or even later, i.e. 3 or more years downstream, whereas the adjustment costs are immediate. Foreign finance was intended to smooth the transition period. However, in the Jamaican case, the anticipated private foreign capital inflows did not materialize. Moreover, the removal of barriers to debt payments drained already scarce international reserves. In the circumstances, program benefits seemed even more remote. As a result, public resentment mounted against the program. Political pressure built up against it, culminating in the rejection of the stabilization program and the breakdown of Jamaica's relationship with the International Monetary Fund.

Conclusion

This paper examined the Jamaican balance of payments crisis and the IMF stablization program in order to better understand the volatile and acrimonious relationship between the International Monetary Fund and its LDC member countries. The crux of disagreements is usually the diagnosis of the balance of payments problem and the design of appropriate stabilization policies. It has been shown that in the Jamaican case, the IMF's analysis of the payments problem is consistent with the empirical situation. The identification of poor production and export performance and the growth retarding and inflationary role of government as the main reasons for the crisis cannot be faulted. The associated policy recommendations in terms of improving production performance, increasing profits rates and shares in national income, and reducing government growth and deficit financing have longer term merit. Nonetheless, short-run adjustment costs are likely to be severe, and the benefits uncertain and distant.

The time preference of Jamaican society is weighted in favor of the present. Adjustment costs consequently seem more important than future benefits. For this reason, the stabilization program is unpopular with large segments of the society. The Jamaican government's own political time preference also seems to be weighted in favor of the present. The perceived short-run political costs outweigh the possible long-run gains. It is not surprising, therefore, that the Jamaican government has opted against the IMF stabilization program.

Jamaican society is now embroiled in political controversy over the adoption or nonadoption of the IMF stabilization program. So far, the debate has centered on ideological issues and short-run solutions of debt rescheduling and debt renegotiation. While of some importance, these matters divert attention from the real decision which the society has to make, namely that of restructuring resource use and production incentives so that the economy grows. There can be no lasting solution to the balance of payments problem unless economic growth is sustained, nor no meaningful and effective redistribution policies in a situation of diminishing national product. To express the choice at this juncture in terms of balance of payments stabilization versus social equity is to misrepresent the choice situation. Stabilization, growth, and equity are closely interrelated. The Jamaican experience demonstrates that social equity is an elusive goal in a declining economy. Painful though the shortrun may be, economic recovery and growth should become the central objective of current Jamaican economic policy.

NOTES

1. Revised version of paper presented to Economic Development Workshop, University of Notre Dame, May 1980.
2. Contrary to official intentions, government consumption expenditures have tended to be regressive in practice.
3. For detailed descriptions of the Extended Fund Facility Stabilization Program, see Government of Jamaica Ministry of Finance Papers Nos. 10 and 34.
4. For example, Williams (6) estimates a positive and significant own price elasticity for Jamaican coffee supply.

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